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New Hampshire Broker - CRE sector has anticipation, along with some anxiety - by Bill Norton

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We know spring is coming. But as I sit here on a sunny, but cold, morning it is still winter. So that leaves us with anticipation. The commercial real estate (CRE) sector has anticipation, along with some anxiety. Inflation, of and by itself, is not always the worst thing for CRE (think rising rents), but after so many years of virtually no inflation, it seems like a new thing. And with inflation comes rising interest rates, along with rising costs (labor, utilities, insurance....) - not a good thing for CRE.

As I write this, we are only anticipating these changes. Right now, we are coasting on the momentum from 2021. Construction costs are so high, folks are focused on existing properties of all types. Even former retail space is being leased and repurposed. Alas, this may be a temporary trend.

Overall, the “macro” picture is not great. There is inflation – 5.9% +/- according to the Fed (and Social Security – thank you for the COLA!). The Fed was backing off Quantitative Easing and talking forcefully about interest rate increases, but now are not so sure. Did I mention this is an election year? Poor Joe Biden must be wondering why he wanted to be in the White House! Oh, and then there is Ukraine – that is what we need right now, an international “invasion” on the edge of NATO.

Back here in New Hampshire, there is not a lot we can do about the macro factors. As I sit with clients, the conversations are: Should I sell? Should I buy? Should I renew my lease? If so, for less square footage? Are market rates peaking and, thus, should I wait? These are all good questions.

Should I sell? Yes, if you do not need the property. Prices are very high, yielding big gains and capital gains taxes WILL increase in the future (but probably not in an election year).

Should I buy? Well, yes if you need the space and have a solid business plan for its use - which might be a strong tenant(s). Interest rates will be rising.

Should I renew my lease? Well, it depends. For office users having suffered through two+ years of COVID, the future is still unclear. Office “occupancy” – people sitting in seats, is down 23-58%. Some of this is permanent. My daughter works for the Federal Department of Transportation. She has been remote/working from home for almost two years. While the big picture is “bring the people back”, that likely will be at 60-75% of previous densities. She has co-workers who have left DC and, with the current housing shortage, simply cannot afford to move back. At some levels workers can be remote. Some will negotiate to come in 1-2 times per month, others 1-2 times per week. My daughter learned that remote is easy (no 30 - 40 minute commute on the Metro,) but the downside is “out of sight, out of mind.” Her work assignments became less and less engaging/interesting. Zoom is OK but diminishes productivity after a while. So, the future of office use is in flux. Many/most tenants are renewing short-term (1-2 years) “as is” in order to hedge their bets.

Within the population of the office workforce, approximately 1/3 are self-sufficient, self-motivated and disciplined to thrive remotely, while 1/3 can do it, cope, manage, but not excel. The other 1/3 are floundering as they need more structure, supervision, mentoring, and team interaction. We

homosapiens are social animals, who want (and need) face to face interactions. This is extremely apparent with the elderly, where isolation during COVID has had major negative outcomes. What will be interesting is how the cohort of recent office workers, most of whom have been fully remote during COVID, will evolve. Do they need or want an office environment? If not now, in the future? We have a client that hired a team of four engineers in upstate New York – all by Zoom – never met them “live”. Is this the “New Normal”? For some, perhaps, but not for most.

Warehouse, distribution, high bay, and manufacturing is in extremely short supply due to the explosion of distribution. Amazon and others are gobbling up open high bay space over 50,000 s/f. This will peter out over time, but not for several years. The cost to build this space has almost doubled. Assuming \$150-\$160 per s/f to build, rents would be 50-70% higher than the market average 18-24 months ago.

Medical space is in serious flux, with so many mergers and acquisitions, and now with severe staff shortages. Having worked in this sector extensively for 30+ years, I look at clients and say “yes you can build it or remodel it, but how are you going to staff it?” A half a million nurses are leaving the profession, not to mention doctors and all other practitioners. The industry should have been focused on health, not healthcare – preventative wellness, but the payment system was not designed that way – when all you have is a hammer, everything looks like a nail.... One positive outcome of COVID is telemedicine which has finally gotten a toehold. Payers now acknowledge that it makes sense. But reimbursement schedules do not promote it. My doctor working from home has to do 8-10 telemedicine “visits” per hour to earn what he would seeing 3-4 patients in the office.

Hospitality, on life support a year ago, is back. People are traveling again for business, as well as for pleasure. Restaurants pivoted to take-out in a big way. Some have shifted there permanently. But where are the workers? They literally have disappeared. Now as businesses try to ramp up, the worker shortage has them scrambling, limiting services. This may become permanent in many cases as some businesses are learning that they can make more with fewer employees. So, disruption and dislocation in this sector will continue.

Speaking of those workers, where are they going to live? Where can they afford to live? Ugh, this is a big lift. Nationally, we are more than 1,000,000 housing units short. In New Hampshire at least 20,000. Twenty thousand! How long will it take to build those units with current zoning and regulations, the shortage of construction workers, as well as architects and engineers and the ongoing extremely high cost of construction. This could be the straw that breaks the camel’s back, especially here in New England. Younger workers are migrating to the sunbelt with less costly options. This constitutes an economic, housing, social and health crisis. We should be looking at “emergency” overrides to spur solutions. Every community in New Hampshire, from the village of Washington to the city of Manchester, should establish a real goal of “X” new units of housing to be built in 3-4 years (of all types, from “apartmentettes” to square footage homes) to meet this need. Failure to do so will find us in a deeper hole in a few years with no service workers, no construction workers, no nursing home and health aids.... The list goes on. It is time to start walking the walk.

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